

sizeable are the corresponding shared and common costs to manage the operations.⁴⁶

136. For example, if the actual copper network requires more maintenance than a least-cost network with more fiber facilities, as NYNEX says it does, then larger maintenance crews are needed than in a least-cost network. Larger maintenance crews, in turn, require more supervisors, human resource involvement, office space, motor vehicles, parking spaces, etc., all of which in one form or another will raise the overhead costs of running maintenance crews. In sum, the embedded network is associated with larger overhead costs than a least-cost network.

137. This Commission, in essence, made the same observation. In paragraph 698 of its First Report and Order, the FCC states:

We note that the sum of the direct costs and the forward-looking common costs of all elements will likely differ from the incumbent LEC's historical, fully distributed costs.

138. In contrast, Ameritech's 1997 budget figures are based on existing technologies and procedures, rather than least-cost, most efficient technologies and procedures, and are therefore undoubtedly *significantly* higher than forward-looking cost figures. Furthermore, the 1997 budget figures are even higher than Ameritech's current expenses, compounding the error.

139. *All evidence -- and Ameritech's own testimony -- indicates that shared and common costs for an efficient firm are at least 20 percent lower than those for an inefficient one.* Thus, Ameritech's Arthur Andersen study overestimates the true shared and common costs of Ameritech

⁴⁶This proportional relationship between the size of a company's operations and the amount of overhead expenses is not only intuitively obvious, it is also easily verified. For example, an examination of the General and Administrative expenses (as reported by LECs in their ARMIS reports) shows this proportional relationship.

by at least 20 percent.

140. First, NYNEX states in its Initial Post Hearing Brief that its “total TELRIC link cost is almost 30% lower than the corresponding embedded costs.”⁴⁷ Again, given that shared and common costs stand in relationship to network investments and expenses, it logically follows that if the TELRIC costs of a forward-looking, least cost network are roughly 30% below the embedded costs of the actual network, then the shared and common costs associated with a forward-looking, least cost network are most likely also 30% below the actual shared and common costs.

141. Second, Ameritech itself, in its Comments in the Illinois Commission’s Docket 96-98, gives a break-down of its costs for Ameritech Illinois (on a base of \$2.4 billion) into economic and uneconomic costs. The analysis, performed consistent with the ICC’s LRSIC rules,⁴⁸ generated the following results:⁴⁹

Incremental costs	55%
Joint cost	12%
Common cost	15%
Residual	18%

The last category “residual” is defined by Ameritech as “...in general, residual cost include, among

⁴⁷ *Id.* at 14.

⁴⁸ Note that the ICC’s LRSIC costs do not include many of the shared costs that are directly allocated under the FCC’s TELRIC methodology. A large share of the shared and common costs identified under the ICC’s LRSIC methodology, therefore, are directly absorbed under the FCC’s TELRIC methodology. This means that, under a TELRIC methodology, the 55% of all costs identified as Incremental Costs would be higher, and the 12% and 15% identified as shared and common costs, respectively, would be lower. In fact, Ameritech’s own testimony in Illinois states that “we determined that TELRICs are 13% higher than LRSICs.” ICC Docket 96-0486, Palmer, page 24. Applying this correction to the numbers below further corroborates the observation that Ameritech is disproportionately burdening the unbundled network elements with shared and common costs.

⁴⁹ CC Docket 96-98, Ameritech Comments, pp. 63 through 69.

other things, embedded or historical costs.⁵⁰” Ameritech also notes that “...residual costs include, among other things, the costs of a service that are not included in TSLRIC.” Ameritech itself, therefore, has demonstrated that a good part of their costs are *uneconomic costs* and should not be included in the TELRICs of unbundled network elements, interconnection services or shared and common costs. Significantly, Ameritech estimates its uneconomic costs to be about 18%. *Again, the Arthur Andersen team seems to have been unaware of these embedded inefficiencies.*

142. *Ameritech’s allocation of shared and common costs disproportionately burdens services bought by new entrants.* An analysis of the Arthur Andersen study reveals that Ameritech is shifting a *disproportionate amount of shared and common costs* onto the carriers that will purchase unbundled network elements. First, although Ameritech calculates that CLECs will purchase approximately ****[Subject to Ameritech Protective Order]**** percent of its loops in its five-state area, it allocates ****[Subject to Ameritech Protective Order]**** percent of its corporate overhead expenses to the cost of the loops its competitors will purchase . Thus, Ameritech burdens its competitors with approximately *three* times their share of overhead costs.

143. To wit, in Ameritech’s five-state serving area, CLECs will purchase, according to Ameritech’s estimates, about ****[Subject to Ameritech Protective Order]****% of Ameritech’s unbundled loops⁵¹ -- yet, the unbundled network elements and interconnection services to be

⁵⁰Id, footnote, p. 68.

⁵¹Based on FCC’s *Common Carrier Statistics*, year end 1995, Table 2.3, pages 27-28, Ameritech serves a total of 18,370,267 lines in its five state serving area. In Ohio, Ameritech witness Dr. Curry testifies that Ameritech currently serves over 19 million lines. (Ohio PUC, Case No. 96-922-TP-UNC, Ameritech Ex. 1.0, page 26.) Ameritech’s shared and common costs study forecasts that ****[Subject to Ameritech Protective Order]**** loops will be purchased by new entrants in Ameritech’s five state region; i.e., ****[Subject to Ameritech Protective Order]****, or less

purchased by CLECs are burdened with no less than **[Subject to Ameritech Protective Order]**% of Ameritech's corporate overhead expenses.⁵²

144. That this comparison is made on the basis of unbundled loops alone, if anything, understates the extent to which Ameritech is pushing its common costs onto its competitors. Using unbundled loops as a proxy for other elements results in a conservative analysis because unbundled loops will most likely be among the more popular network elements. Therefore, the number of loops leased to competitors as a percentage of total loops is likely to be larger than, say, the number of ports leased to competitors as a percentage of total number of ports. Thus, even if the proper percentage of Ameritech's overhead costs imposed on its competitors was appropriate with respect to loops alone -- which, as explained above, it dramatically was not -- it would still have been significantly too high when considered, as it must be, with respect to all the Ameritech network elements leased to CLECs. Thus, the share of common costs Ameritech imposes on competitors is far more than three times too high.

145. Neither Arthur Andersen nor Ameritech verify their treatment of unbundled network elements leased by CLECs by taking into account the network elements used and to be used by their other business units. Indeed, the study appears *deliberately* designed to obscure the relationship between the shared and common costs assigned to facilities, loops, ports, etc., used as inputs into

than **[Subject to Ameritech Protective Order]**% of the loops are unbundled loops.

⁵²Corporate overhead expenses are \$**[Subject to Ameritech Protective Order]**. UNEs are allocated shared corporate costs of \$**[Subject to Ameritech Protective Order]** and common corporate costs of \$**[Subject to Ameritech Protective Order]** (calculated as \$**[Subject to Ameritech Protective Order]**), which is a total allocation of \$**[Subject to Ameritech Protective Order]**. Thus, UNEs are allocated **[Subject to Ameritech Protective Order]**% of corporate overhead expenses.

Ameritech's retail services and those that make up the unbundled network elements. The study thus obscures the fact that unbundled network elements to be purchased by new entrants are allocated a very disproportionate, higher share of the shared and common costs.

146. Assignment of a disproportionate amount of shared and common costs to unbundled elements to be purchased by new entrants is inconsistent with TELRIC methodology and the provisions of the Act of 1996. Under a proper TELRIC methodology there should be no difference, from a cost perspective, between those loops that CLECs will eventually lease, and those that Ameritech will itself use. There is no reason, therefore, to assign some loops higher shared and common costs than others. In fact, at this point Ameritech would not even be able to identify which of its loops will be leased and which will not. *At the risk of trivializing the issue, one would want to ask, are the loops with the lower mark-ups also available to new entrants, or are those loops available only to Ameritech's business units?*

147. *Ameritech's shared and common costs studies treat AIIS as a start-up company and prevent new entrants from sharing in the economies of scale of Ameritech.* This is directly contrary to this Commission's conclusions that the Act requires incumbents permit "new entrants to enter local markets by leasing the incumbent LECs' facilities at prices that reflect the incumbents' *economies of scale and scope.*" *First Report and Order* ¶ 232.

148. The only purpose served by Ameritech's assumptions is to raise the costs of its competitors unnecessarily. Good public policy and economics discourages an unnecessary duplication of networks if the existing network is in fact the low-cost network. Such duplication would only increase the enormous investments that are already needed to introduce competition into

local exchange markets. The only way to ensure that new entrants will not be forced to unnecessarily overbuild their networks is to offer existing facilities at prices that reflect the true economic costs of leasing facilities from the incumbent LECs. This is, of course, why Congress required incumbent LECs to do so. Since the true economic costs of the existing network are characterized by economies of scale and scope, proper cost studies should reflect such economies.

149. Ameritech's shared and common cost studies are inconsistent with this guiding principle, identifying all sorts of start-up costs, as if the business unit of AIIS which sells the unbundled network elements to new entrants, were a stand-alone company. That is, Ameritech ignores the fact that the unbundled network elements to be purchased by new entrants are *indistinguishable* selections from the elements that form the rest of its network.

150. Ameritech's costing methodology here is inappropriate. The use of stand-alone costs for such a tiny fraction of Ameritech's facilities makes that the *per unit* allocation of shared and common costs critically dependent on forecasted demand. This is because most of the costs are fixed pools of dollars that do not vary with the number of unbundled network elements. What varies, in this approach, is the amount of shared and common costs allocated to the individual network elements. By analogy, if 6 students order a large pizza, each can have two slices. But if an additional 6 students join them, each student can have only one slice. That is, if the amount of pizza is fixed, the average amount to be allocated to each student must vary.

151. So it is with Ameritech's method for allocating shared and common costs. Because the pool of dollars is relatively fixed, the average mark-up for individual network elements will vary depending on demand forecasts. For example, if only half the number of currently projected sales of

unbundled network elements were included in the study, the per unit shared and common costs would go up dramatically -- in fact, *it would double*. Conversely, if twice the volume of unbundled elements were used in the study, then the per unit allocation of shared and common costs would only be *half* as large.

152. To see that this is true, consider the situation discussed by Mr. Broadhurst on Schedule 2 of his affidavit in MPSC Case No. 11280. Mr. Broadhurst identifies monthly shared costs for unbundled local loops in rate Access Area A of \$**[Subject to Ameritech Protective Order]**. This calculation is based on a forecast of **[Subject to Ameritech Protective Order]** unbundled loops. If the forecasts for all unbundled elements were to *double*, then the shared costs for unbundled loops in Access Area A would drop to \$**[Subject to Ameritech Protective Order]** (which is \$**[Subject to Ameritech Protective Order]** divided by 2). If, on the other hand, these the forecasts for all elements were cut in half, then the shared costs for these loops would double to \$**[Subject to Ameritech Protective Order]** (which is \$**[Subject to Ameritech Protective Order]** times 2).

153. Note that the allocations of shared and common costs to network elements for Ameritech's own retail services are unaffected. *That is, while the per unit allocations of shared and common costs to unbundled network elements can vary wildly, Ameritech's own costs for network elements are unaffected.* Clearly, this is discriminatory.

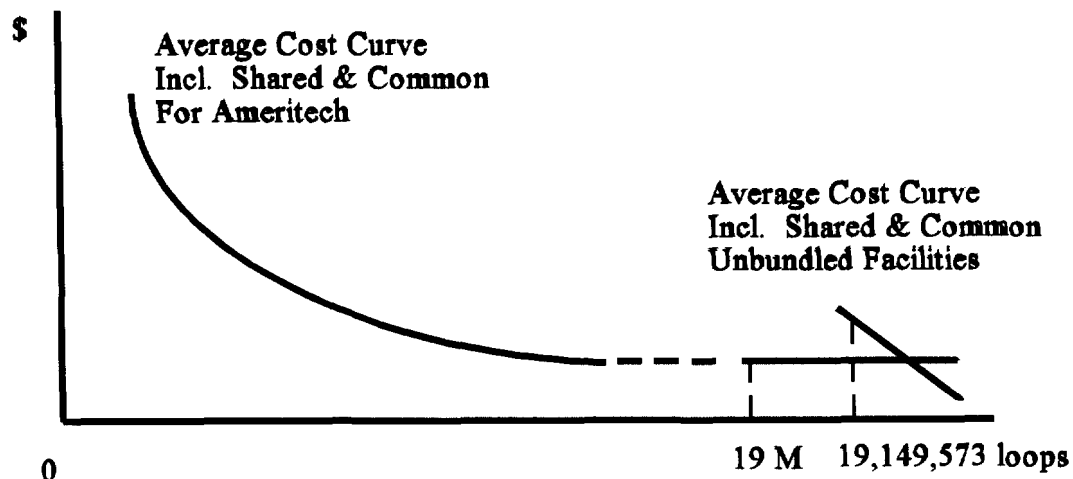
154. This effect is also contrary to the notion that large firms like Ameritech have generally depleted their economies of scale and are now operating at relatively *constant* economies of scale. That is, when output increases, the average costs per unit remains relatively constant. For

example, if Ameritech constructs an additional 100 loops, the cost per loops should be roughly the same as the per loop cost for the previous 100 loops, constructed under similar circumstances.

155. The unbundled network elements constitute only a *tiny* fraction of the company's total output. Thus, it should be *impossible* that changes in projected demand for unbundled network elements have any effect on the *per unit* shared and common costs.

156. As shown in this figure, Ameritech's average costs, including shared and common costs, remain constant because at current output levels, Ameritech is experiencing constant economies of scale.⁵³ By contrast, in Ameritech's calculations the average costs, including shared and common costs, for *unbundled loops* varies greatly with the level of output. If the forecasted output for unbundled loops goes up, the average cost for unbundled loops drops sharply because the shared and common costs are now allocated over a much larger number of unbundled loops. This effect is inconsistent with the underlying situation and the requirements of the statute, and arises only because Ameritech treats the business unit of AIIS that sells the unbundled network elements as a start-up operation. Ameritech thus *deprives* new entrants of the economies of scale experienced by the rest

⁵³ For the sake of simplicity, I am ignoring that average costs may vary across states because conditions vary across states. This simplifying assumption does not alter the fundamental observation, however, that Ameritech treats unbundled loops -- loops leased to its competitors -- differently from loops it uses itself.



of its network.

157. Furthermore, this approach permits Ameritech to completely determine the outcome by choosing the demand forecast. By changing the demand forecasts, Ameritech can target precisely the level of shared and common costs that it wants to allocate to unbundled network elements, and therefore the prices it wishes to impose upon its competitors.

158. *Ameritech's allocation of shared and common costs across network elements is also anticompetitive.* As this Commission has determined, shared and common costs must "be allocated among *elements* and *services* in a reasonable manner, consistent with the pro-competitive goals of the 1996 Act." *First Report and Order* ¶ 695) (emphasis added). Thus, cost allocation schemes that impede competitive entry by burdening the network elements that will be most useful to new entrants more than other network elements are prohibited.

159. Ameritech further discourages competitive entry by imposing a greater percentage

mark-up for shared and common costs onto network elements of greatest immediate interest to its competitors. Identical loops in different geographic areas carry different markups for shared and common costs. For example, unbundled loops in urban business districts are burdened with higher markups than their business loop counterparts in more rural areas. The percentage markup for basic business loops in Access Area A is *1.6 times* as large as the percentage mark-up for the same type of loops in Access Area C.

160. In addition, different types of loops carry different markups for shared and common costs, with those most important to competitive entry carrying the highest load. Thus, the percentage mark-up for basic business loops in Rate Zone A is *3.7 times* as large as the percentage mark-up for a 4-Wire Analog loop in Rate Zone C.

161. An examination of contribution levels reveals a pattern of disproportionately -- and strategically -- raising the price of network elements that would be most useful for new entrants.

162. Ameritech's allocation of shared and common costs *inversely* to how essential network elements are for new entrants is totally at odds with this Commission's directives. *See, e.g.*, ¶ 696.

163. *Ameritech's shared and common costs studies also do not adequately eliminate all retail-related expenses.* This is contrary to this Commission's determination that retail-related expenses, including indirect expenses such as a proportional share of shared and common costs, should be excluded. *See First Report and Order* ¶ 691 ("retailing costs, such as marketing or consumer billing costs associated with retail services, are not attributable to the production of network elements that are offered to interconnecting carriers and *must not be included* in the

forward-looking direct cost of an element”) (emphasis added).

164. The notion here is that retail related expenses are not associated with the LEC’s wholesale activities and therefore should not be recovered from the LEC’s wholesale services, such as unbundled network elements.

165. An examination of the workpapers of Arthur Andersen filed in MPSC Case No. 11280 reveal numerous instances in which costs are categorized as shared and common costs to be recovered from unbundled network elements that are, in fact, retail related. Some egregious examples are the inclusion of expenses related to Ameritech’s sponsorship of the *Senior Open* golf tournament (\$**[Subject to Ameritech Protective Order]**) and \$**[Subject to Ameritech Protective Order]** in corporate charitable contributions. Clearly, sponsorship of golf tournaments and charitable contributions are public relationship/advertising related expenses that are largely unrelated to unbundled network elements and should surely not be included in their shared and common costs. They should be recovered from Ameritech’s retail activities. Imposing such expenses on CLECs when they purchase wholesale elements simply serves to needlessly raise the costs of Ameritech’s competitors.

166. Mr. Broadhurst, the supervising partner of the Arthur Andersen team, was asked in his deposition in the Ohio proceeding why such costs were included. Mr. Broadhurst responded that his guiding principle was whether expenses benefited the company.⁵⁴ That, however, is most specifically not the appropriate criterion under the statute or under this Commission’s Order, which expressly prescribes inclusion of retail-related expenses, whether or not they benefit the company,

⁵⁴ Broadhurst deposition, Ohio PUC, Case No. 96-922-TP-UNC.

in the shared and common costs for unbundled network elements and interconnection.

Shared Costs in Ameritech's study

167. Ameritech allocates a total of \$**[Subject to Ameritech Protective Order]** in shared costs to unbundled network elements. The sources for this amount are three fold: \$**[Subject to Ameritech Protective Order]** from AIIS; \$**[Subject to Ameritech Protective Order]** from Corporate; and \$**[Subject to Ameritech Protective Order]** from AOC and State Administration.⁵⁵ Unless otherwise indicated, these numbers come from the workpapers of Mr. Broadhurst that were supplied during discovery in Michigan's generic cost docket.

168. *Shared cost from AIIS directly assigned to unbundled network elements.* In general, the \$**[Subject to Ameritech Protective Order]** is explained as the sum total of shared costs assigned to unbundled network elements for the following:

\$**[Subject to Ameritech Protective Order]** assigned to "unbundling"	Wages for AIIS personnel
\$**[Subject to Ameritech Protective Order]**	Associated benefits
\$**[Subject to Ameritech Protective Order]** expenses"	"other employee related
\$**[Subject to Ameritech Protective Order]**	"contract services"
\$**[Subject to Ameritech Protective Order]**	Advertising
\$**[Subject to Ameritech Protective Order]**	bad debt

169. The shared cost categories "Wages for AIIS personnel assigned to unbundling" and "Associated Benefits" are inflated. The first set of numbers are terribly inflated, as all of these wages and benefits are based on Ameritech's assignment of headcount within the AIIS unit to one of its

⁵⁵ Unless I indicate otherwise, the numbers I cite come from the workpapers of Mr. Broadhurst that were supplied during discovery in Ohio PUC, Case No. 96-922-TP-UNC and MPSC Case No. 11280.

various business units. These assignments appear arbitrary and inappropriately impose costs on unbundled network elements.

170. A few examples:

- Mr. Ray Thomas' time is allocated to unbundling. Based on the organizational charts supplied by Ameritech, however, Mr. Thomas is the "General Manager/Sales and Service/CAPS/ CATV/Resellers."⁵⁶ Thus, allocation of 100 percent of his salary to unbundling is not justifiable. As Mr. Thomas is misallocated, so is his assistant Sandy McDuff. In addition, in Mr. Thomas' organization is Mr. Gary McCoy. Mr. McCoy's title is "Account Manager - CATV." Based on this title, it is clearly inappropriate to allocate his salary to unbundled network elements. Overall, Ameritech assigns **[Subject to Ameritech Protective Order]** headcount (including the three above) to unbundled elements and interconnection. Since three of these salaries are misallocated, that implies that roughly **[Subject to Ameritech Protective Order]** percent of the wages of Mr. Thomas' organization have been misassigned to unbundling. The total amount of wages from Mr. Thomas assigned to unbundling is \$**[Subject to Ameritech Protective Order]**.

- There are two positions in an organization of Mr. Ashworth that raise further questions. One is vacant and is only a budgeted position. The other position is held by Mr. John Earle, whose title is "Account manager -- Wireless." These also seem to be mis-allocations. Half the salary figure from this organization appear misallocated.

- In Mr. B. DeFrance's organization, three positions appear misassigned. They are:

⁵⁶ The job titles of these individuals were provided in Ameritech's response to OCC-2-17, Ohio PUC, Case No. 96-922-TP-UNC.

Neil Burnett, whose title is “product manager - mutual compensation”; Steve Johnson, whose title is “market development”; and William Jerome, whose title is “Market Development and ALDIS support. These titles indicate that these persons do not work with unbundled elements and therefore should not be included. Since there are **[Subject to Ameritech Protective Order]** headcount from DeFrance’s organization assigned to unbundling and the total wages from Mr. DeFrance’s organization assigned to unbundling is \$**[Subject to Ameritech Protective Order]**, **[Subject to Ameritech Protective Order]** appears to be misallocated. Further salaries for two other employees are misallocated, which adds an additional \$**[Subject to Ameritech Protective Order]** improperly imposed on competitors who purchase unbundled elements.

- In addition, at least one person in Mr. Thornton’s organization has been misassigned to unbundling. Mr. Tom Grzadzinski has been assigned to unbundling, but his job title is “Manager - Telemanagement.” This misallocation similarly imposes additional unnecessary costs on competitors of \$**[Subject to Ameritech Protective Order]**.

171. The sum total of the unnecessary costs in misallocated wages that I have been able, with this limited information, to identify is \$**[Subject to Ameritech Protective Order]**. In addition, all benefits associated with these wages are inappropriate, which amount to approximately \$**[Subject to Ameritech Protective Order]**.

172. There may be other wages wrongly assigned to unbundled elements and interconnection. For example, Arthur Andersen itself acknowledged that at least one headcount relating to poles, ducts, conduits and rights-of-way had been wrongly assigned to unbundling, amounting to a misallocation of wages and benefits of \$**[Subject to Ameritech Protective

Order]**.⁵⁷

173. *The shared cost category “other employee related expenses” is also artificially inflated.* The “other employee related expenses” costs relate to computers and other items that, as the name implies, relate to employees. Because Ameritech misassigned headcount to unbundled elements and interconnection, a related proportion of these expenses is also misallocated.

174. *The shared cost category “contract services” is also artificially inflated.* \$**[Subject to Ameritech Protective Order]** is related to costs for “carpeting, painting” and so forth for additional employees assigned to unbundled elements and interconnection.⁵⁸ Given that a number of positions were misassigned, this number therefore also is overstated by approximately \$**[Subject to Ameritech Protective Order]**.

175. *Shared cost from Corporate directly assigned to unbundled network elements are inflated.* The shared costs from Corporate that are directly assigned stem from three sources: \$**[Subject to Ameritech Protective Order]** from Corporate strategy department; \$**[Subject to Ameritech Protective Order]** from Corporate Public Policy Department; and \$**[Subject to Ameritech Protective Order]** from Corporate legal Department.

176. Based on the workpapers supplied by Ameritech, the \$**[Subject to Ameritech Protective Order]** relates to an employee in Corporate Strategy part of whose time is “spent reviewing issues relating to resale and unbundling.” Similarly, the \$**[Subject to Ameritech Protective Order]**, according to Ameritech’s workpapers, is a “projected amount ... which will be

⁵⁷ See AIIS shared cost study analysis

⁵⁸ See Rotundi dep. at 38, Ohio PUC, Case No. 96-922-TP-UNC

directly attributable to unbundling/resale.” From the papers, these expenses appear to be incurred for Ameritech’s benefit and not for the benefit of new entrants.

177. Similarly, the cost category for “Corporate Legal Department” appears to be misassigned to shared costs. According to Ameritech witness Mr. Don Carlson, the source of these cost numbers, the bulk of these expenses are outside counsel fees related to “arbitration [proceedings] and the statements of generally available terms and the tariff filings and the cost proceedings and the resulting litigation.”

178. It is totally inappropriate for Ameritech to recoup its legal expenses with respect to Section 252, Section 271 and related proceedings from new entrants, much less solely from new entrants. All of these expenses are spent on securing *Ameritech’s* interests, and most are spent on opposing efforts by those very new entrant who would be forced to pay them as they purchase unbundled network elements. Meanwhile, the new entrants have already incurred massive legal expenses of their own. Indeed, those expenses are more appropriately recovered from Ameritech’s retail operations, which is what Ameritech is protecting with its legal efforts. As such, they are retail related expenses.

179. Furthermore, even if it were appropriate to impose these costs on new entrants, it is wholly inappropriate to include the expenses from the period immediately following the Telecommunications Act, as if they will reoccur year-after-year -- which is the effect of including them in the shared cost category. These expenses are mostly one-time expenses that cannot plausibly be expected to reoccur at anything like a comparable level. In his deposition, even Mr. Carlson

confirmed that he would *not* expect these types of costs to recur in coming years.⁵⁹ In any event, they are not long-run, forward-looking expenses that should be considered here.

180. Finally, Mr. Carlson's used a very broad definition of "unbundling" to determine these costs, it is certainly inappropriate to assign these costs, which included resale and other activities not related solely or at all to unbundled network elements and interconnection.

181. *Shared cost from AOC and State administration directly assigned to unbundled network elements.* The shared cost from AOC and State Administration stem from two sources: **Subject to Ameritech Protective Order** from Public Policy Department; and **Subject to Ameritech Protective Order** from Legal Department.

182. *The shared cost category from the Public Policy Department are misassigned.* The allocation is inappropriate for the following reasons. First, **Subject to Ameritech Protective Order** of these expenses are related to outside consultant fees, such as Arthur Andersen and Law and Economics Group.⁶⁰ These are expenses related to representing *Ameritech's* interests in proceedings for implementing the provisions of the Telecommunications Act of 1996. These costs should not be recovered from new entrants.

183. Much of the remainder of the expenses are likewise inappropriate. Based on the workpapers supplied, these are salaries for individuals within Ameritech's Public Policy Group whose salaries have been assigned to "unbundling." There are several problems here.

⁵⁹ As Mr. Carlson stated, he expected that these expenses should be "wrapping up this year, in '97." Carlson dep., Ohio PUC, Case No. 96-922-TP-UNC

⁶⁰ Ms Ruth Anne Cartee provided this information during her deposition in Ohio. Ohio PUC, Case No. 96-922-TP-UNC

184. First, it appears that these individuals have been misassigned to unbundling. For example, Mr. **[Subject to Ameritech Protective Order]**'s salary has been included at 100%; however, it is my understanding that Mr. **[Subject to Ameritech Protective Order]** does work for unbundling, resale, and in support of cost studies for price floors for Ameritech's retail services. Mr. **[Subject to Ameritech Protective Order]** is, according to Ameritech witness Ms Cartee in her deposition in Ohio, "primarily associated with resale preparations." His salary, however, was included as relating to unbundling. Similarly, other people on the list of Ameritech Public Policy employees originally assigned to unbundling -- such as Mr. **[Subject to Ameritech Protective Order]**, Ms. **[Subject to Ameritech Protective Order]** -- should be, according to Ms Cartee, "zeroed out." Other assignments of Public Policy employees are also suspect. Employees as "state regulator advocates" have portions of their salaries assigned to unbundling. Mr. **[Subject to Ameritech Protective Order]**'s salary is 100% included in unbundling (as are many of his employees); however, Mr. **[Subject to Ameritech Protective Order]** spends much of his time on long term number portability issues and other issues.⁶¹ Consequently, it is inappropriate to assign his salary solely to unbundling. These are just some examples of the mis-assignments or the questionable assignments in Ms Cartee's analysis that formed the basis of the assignment of costs to unbundling.

185. *The shared cost in the category "Legal Department" have been misassigned.*

⁶¹ Indeed, according to Ms Cartee, long term number portability issues are properly assigned to the unbundling category. Cartee dep. Ohio PUC, Case No. 96-922-TP-UNC. Again, this demonstrates how improperly broad definitions of "unbundling" can lead to mis-assignment of costs to unbundling.

According to Mr. Carlson, these costs -- which are one third of the AOC/State Administration legal costs -- were determined on the same basis as he determined "unbundling" costs in the Corporate Legal Department. These costs should not be imposed on competitors for the same reasons that the previously discussed legal costs are inappropriate.

Common Costs in Ameritech's study

186. Ameritech's common costs stem from five basic sources:

Network services "common" costs	--	\$ **[Subject to Ameritech Protective Order]**
AOC/State Admin "common" costs	--	\$**[Subject to Ameritech Protective Order]**
Corporate "common" costs	--	\$ **[Subject to Ameritech Protective Order]**
AIIS NPS "common" costs	--	\$ **[Subject to Ameritech Protective Order]**
AIIS (all) "common" costs	--	\$ **[Subject to Ameritech Protective Order]**

187. The allocation process works as follows: Network Services "common costs" are allocated to AIIS using the "general allocator" of **[Subject to Ameritech Protective Order]**%. Then, once allocated to AIIS, it gets allocated to unbundled elements using the direct unbundling expense to total AIIS allocator of **[Subject to Ameritech Protective Order]**%. This results in \$**[Subject to Ameritech Protective Order]** in Network Common Costs being added on to unbundled elements.

188. Next, AOC/State Administration "common" is allocated using a combination of allocators essentially **[Subject to Ameritech Protective Order]**% for real estate, **[Subject to Ameritech Protective Order]**% for Information services expenses, and **[Subject to Ameritech Protective Order]**% (the general allocator) for everything else. This results of \$**[Subject to Ameritech Protective Order]**, after exclusion of what is presumed to be in TELRIC, is allocated to AIIS. This then gets multiplied by the **[Subject to Ameritech Protective Order]**% allocator

("direct unbundling" to all AIIS) resulting in \$**[Subject to Ameritech Protective Order]** in AOC/State Administration costs being allocated to unbundling.

189. Corporate "common" costs first are multiplied by a "core/non-core" allocator of **[Subject to Ameritech Protective Order]**%, then multiplied again by the "general allocator" of **[Subject to Ameritech Protective Order]**%. This results in \$**[Subject to Ameritech Protective Order]** being allocated to AIIS. Then this number is multiplied by the **[Subject to Ameritech Protective Order]**% allocator which assigns costs directly to unbundling in AIIS, resulting in \$**[Subject to Ameritech Protective Order]** in Corporate "common" being allocated to unbundling.

190. AIIS NPS "common" is multiplied by a special **[Subject to Ameritech Protective Order]**% allocator representing the ratio of direct unbundling costs to AIIS-NPS costs. This results in \$**[Subject to Ameritech Protective Order]** being allocated to unbundling.

191. Last, but not least, the AIIS (All) "common" is multiplied by the **[Subject to Ameritech Protective Order]**% direct unbundling to total AIIS allocator, resulting in \$**[Subject to Ameritech Protective Order]** being allocated to unbundling.

192. The grand total of "common" costs allocated to unbundling this way is: \$**[Subject to Ameritech Protective Order]**.

193. *Ameritech over-allocates common costs to unbundled network elements.* First, the general starting point for its analysis are 1997 budget numbers that do not reflect least cost, most efficient technology and procedures as discussed above. That is, the 1997 budget figures do not provide forward-looking costs. Therefore, any analysis based on this flawed data will necessarily

overestimate the common costs to be assigned to unbundled network elements. As explained above, I estimate these budgets to be generally at least 20% too high.

194. Second, also as previously discussed, Ameritech fails to appropriately exclude retail expenses. For example, the following expenses are inappropriate because they are retail related: \$**[Subject to Ameritech Protective Order]** for the Senior open golf tournament; \$**[Subject to Ameritech Protective Order]** for sky-boxes at various sporting arenas; \$**[Subject to Ameritech Protective Order]** for the Museum of Science and Industry in Chicago; \$**[Subject to Ameritech Protective Order]** for the Ameritech Cup; \$**[Subject to Ameritech Protective Order]** for "In Performance at the White House;" \$**[Subject to Ameritech Protective Order]** in corporate charitable contributions. *This is not an exhaustive list.*

195. Third, in the AOC/State Administration IS costs Ameritech has failed to eliminate a number of expenses that should have been assigned to Ameritech's retail operations. For example, Ameritech's responses to MCI's third set of data requests, in Ohio PUC, Case No. 96-922-TP-UNC, reveal the following: ProcSol VG2 (\$**[Subject to Ameritech Protective Order]**), these are retail expenses related to printing of Ameritech's customers' bills; ECS/AM VG3 (\$**[Subject to Ameritech Protective Order]**), which are retail related expenses for systems that allow Ameritech to "establish, maintain, and change customer account information;" BillSol VG6-7 (\$**[Subject to Ameritech Protective Order]**) relates to computer "applications that allow Ameritech to bill customers for telephone usage;" RAO VGC (\$**[Subject to Ameritech Protective Order]**) relates to "correction of service order, toll usage, and account errors, also handles returned mail, duplicate billing and special bill processing;" CPPO VGD (\$**[Subject to Ameritech Protective Order]**)

"manages remittance of Ameritech telephone customer bill payment." All of these are retail related expenses. At the very least, these are expenses that are not related to AIIS. As Ms Rotundi explained in her deposition, AIIS spends millions of dollars (of AIIS common costs) relating to billing and information services development. They should be excluded as relating to resale.

196. Fourth, certain legal expenses, such as the legal expenses of Ameritech 271 applications under the Act, have not been removed. Clearly, having filed and refiled applications with the FCC pursuant to Section 271 of the Telecommunications Act, Ameritech has and will incur significant legal expenses relating to supporting these applications *for entry into the long distance market*. However, none of these legal expenses are incurred in order to provide unbundled network elements and interconnection to local telephone service competitors and therefore it is wholly inappropriate for Ameritech's local competitors to pay them. However, Mr. Carlson, the person within Ameritech who examined corporate legal expenses, did not even look to exclude such costs.⁶²

197. Further, while Ameritech directly assigned significant dollars to "unbundling," it does not appear to make any direct assignments of expenses to "resale." This suggests, again, that Ameritech is mis-allocating resale costs, which are not recovered based on a cost analysis under the statute, as unbundled element and interconnection costs, which may be recovered based on a cost analysis.

198. Fifth, Ameritech's efforts in excluding expenses that are already included elsewhere was flawed. Ameritech's approach here was so inconsistent with its approach to other calculations

⁶² Moreover, Mr. Carlson did not look for other types of expenses that should be excluded, including legal fees relating to Ameritech's wireless operations, ACI, or international. Carlson, dep., Ohio PUC, Case No. 96-922-TP-UNC.

that it is impossible to know whether there is double counting going on. What Ameritech did, basically, was to attempt to discern, by looking at the various functions within a group whether those types of costs would have been already included. When they believed that certain types of costs were already accounted for, then the 1997 budgeted dollars were excluded. There is no way to verify, however, whether: a) Ameritech properly found all of the TYPES of costs that were already included, or b) when they did, whether they excluded sufficient costs.

199. Sixth, the various allocators appear to be skewed. For example, the core/non-core allocator improperly excludes "new ventures" from the mix. Ameritech would have us believe that there are only two divisions within Ameritech corporate -- core telephone and non-core telephone. Based on the core/no-core telephone bifurcation, Ameritech allocates **[Subject to Ameritech Protective Order]**% of corporate to core and **[Subject to Ameritech Protective Order]**% to non-core telephone activities. This is fundamentally wrong. There are actually three major branches - core telephone, non core telephone, and new ventures. New ventures includes **[Subject to Ameritech Protective Order]** etc. When new ventures is included in the mix, the allocation to core tel (and then down to AIIS and down to unbundling) moves from **[Subject to Ameritech Protective Order]**% to **[Subject to Ameritech Protective Order]**%.

200. Although Ameritech may have attempted to remove all expenses relating to "new ventures" from Corporate costs, that exclusion would not prevent new ventures from receiving their proper share of the "true" common costs of the company. For example, it appears that under the way Ameritech method, none of Ameritech's CEO's, Mr Notebaert, salary is allocated to new ventures, a result which is clearly unacceptable.

201. Next, the **[Subject to Ameritech Protective Order]** general allocator of "coretel" costs to AIIS appears inflated. To the extent that the **[Subject to Ameritech Protective Order]** allocator is based on the inclusion of mutual compensation expenses in the budget of AIIS, then this allocator may be too high. These expenses incurred in mutual compensation, however, are retail related expenses incurred by Ameritech when its customers call off-net. They do not appear to be appropriately included in the analysis of common costs for unbundled network elements and should have been excluded.

202. Eight, the **[Subject to Ameritech Protective Order]** and **[Subject to Ameritech Protective Order]** allocators of direct unbundling to AIIS and to AIIS-NPS, respectively, are likewise inflated. (These allocators were used to take "common" costs down to unbundled elements.) The **[Subject to Ameritech Protective Order]** allocator is based on total of "unbundled" budget (minus costs associated with mutual compensation) *divided* by total NPS and IPS budget. The problem here is that the "unbundled budget" even with the mutual compensation removed is still inflated. First, to the extent I have already identified AIIS costs that have been over-allocated to unbundling, those costs should be removed from the numerators for the purpose of calculating these allocators. Second, the "Unbundling J1727 Initiative, " accounts for a total of **[Subject to Ameritech Protective Order]** in the numerator of this allocation ratio. Based on Ameritech's response to information requests, this initiative covers more than unbundled network elements, but also includes "a wholesale product line birth from the retail product line." This appears to relate to resale, and if so, the costs of this initiative should not be solely assigned to unbundling. Second, there is the 2 PIC J1733 Initiative for a total of **[Subject to Ameritech Protective**

Order]**, relating to the implementation of two PIC software in switches to allow for intraLATA equal access.⁶³ Certainly, these expenses should not be assigned to unbundled elements at all.

Ameritech's Proposals to Recover Additional "Residuals" Through Unbundled Network Elements and Interconnection Services

203. Ameritech may impose additional costs on competitors for "residuals" if permitted by the state commission.

204. Ameritech witness Dr. Aron testified to the Michigan Commission:

If the FCC Order is vacated by the Eight Circuit, Ameritech should be permitted to recover from prices set for the UNEs the residual costs I describe below.⁶⁴

205. Dr. Aron then identified two possible sources of "residuals": (1) real-estate related costs, and (2) costs of spare capacity that are not already included. Dr. Aron also noted that "I do not know if the costs that I have described above comprise Ameritech's entire residual."⁶⁵

206. Ameritech's "residual" referred to in the testimony of the Ameritech witnesses are embedded costs that are not efficiently incurred. This "residual" is calculated as the difference between Ameritech's *total revenues* and Ameritech's expenses based on TELRIC or TSLRIC studies, including joint and common costs. By definition, therefore, the "residual" -- *if they do represent costs* -- are costs that are not efficiently incurred.

⁶³ Descriptions of these initiatives are found in an Ameritech response to an OCC information request, Ohio PUC, Case No. 96-922-TP-UNC.

⁶⁴ Aron Affidavit, p. 32, MPSC Case No. 11280.

⁶⁵ *Id.*